New York
Mercantile Exchange

January 27, 2006

The Honorable Reuben Jeffery III
Chairman
Commodity Futures Trading Commission
1155 21st St., N.W.
Washington, D.C. 20581

Dear Chairman Jeffery:

I am submitting this letter on behalf of the New York Mercantile Exchange, Inc. (NYMEX or Exchange) to express our deep concerns about the plans recently announced by the Intercontinental Exchange, Inc. (ICE) for electronic trading in the US. Specifically, ICE has announced the listing of a new West Texas Intermediate (WTI) crude oil futures contract on ICE Futures, its wholly-owned subsidiary futures exchange that is not subject to regulation by the Commodity Futures Trading Commission (CFTC or Commission).

Let me first acknowledge that NYMEX competes with ICE itself, which is currently operating as an exempt commercial market, and with ICE Futures in various product lines. NYMEX has long been a champion of fair competition, and we are certainly prepared to compete with ICE or other competitors in New York or in Atlanta or anywhere else in the world. However, ICE's announcement raises important regulatory policy issues that could impact dramatically the Commission's effective oversight of US futures markets and implicates a number of other serious policy issues that warrant careful consideration by the full Commission at this time. ICE Futures should not be permitted to make available the new WTI Futures contracts for trading in the US until the Commission has had the opportunity to complete a deliberate and measured review of the policy concerns set forth in this letter.

The new WTI crude oil futures contract would be listed and made available for trading by persons and firms in the US pursuant to a 2003 no-action letter (CFTC Letter No. 03-17) issued by staff of the Division of Market Oversight (DMO or Division). (ICE Futures was formerly known as the International Petroleum Exchange Ltd. (IPE)). This letter was the latest in a series of several letters issued to the IPE by Division staff permitting "foreign terminals" for electronic trading for IPE products to be "placed" or otherwise made available in the US for trading the IPE's foreign futures contracts without requiring the IPE to register with the Commission as a contract market or subjecting IPE to Commission regulation or oversight.

After the initial no-action letter issued to the IPE on November 12, 1999, the IPE then received three additional letters that expanded the scope of relief afforded to the IPE.

CFTC Letter No. 02-96, which permitted IPE to migrate the trading of its UK Natural Gas futures contract from the IPE trading host in London to ICE's trading platform in the U.S., was granted because the UK Nat Gas contract had limited US participation. The IPE was required to request specific permission to add new types of contracts to the ICE platform in the US. Subsequently, CFTC Letter No. 03-08 expanded the earlier relief to Brent and Gas Oil futures. Again, the relief was predicated on the IPE not envisoining significant trading volume from US. CFTC Letter No. 03-12 permitted the IPE to expand the trading hours for the foregoing contracts, under the same conditions. All three letters referenced the fact that the trading in the contracts was to be conducted predominantly by UK and European counterparts. Clearly, the issuance of these letters by DMO staff was predicated upon an assumption by DMO and representations from IPE that IPE did not envision significant trading volume from the US and only limited US participation in its foreign futures contracts.

In the context of yet another request by IPE to expand its electronic trading hours, DMO staff, presumably to minimize the need for the IPE to come back to DMO staff for prior approval each time it wanted to apply the expanded relief to a new foreign futures contract, stated in footnote 6 of CFTC Letter No. 03-17 that the IPE could apply the relief to all such new contracts without further supplementary relief from the Commission or Commission staff.

To any reasonable observer, it would seem to stretch credulity to believe that DMO, or the Commission, could have envisioned or intended that this footnote would be construed and exploited by ICE to permit ICE Futures to list a contract with substantial US participation, such as the WTI futures contracts, for trading electronically in the US without registering ICE with the CFTC as a contract market.

This approach by DMO staff in footnote 6 of Letter No.03-17 presumably was undertaken against the backdrop of the 2000 policy statement by the Commission that permitted the listing by notice to the CFTC of new futures and options contracts by foreign boards of trade that had received foreign terminals no-action relief. It also may have seemed appropriate based upon the relevant facts that were known at the time of the issuance of CFTC Letter No.03-17. Specifically, at the time of the issuance of that DMO no-action letter, the IPE maintained an open outcry trading floor in London, where the majority of the volume of its business was transacted and did not list any US-based futures contracts. Indeed, it is our understanding that all of its products had an underlying physical commodity involving energy markets either in the United Kingdom or in Northern Europe.

Subsequent to that letter, the IPE determined to shut down its trading floor in London and shift all trading to ICE's Atlanta-based system. Additionally, as noted, ICE is now intending to list this WTI crude oil contract as part of the ICE Futures "foreign" product slate. Consequently, WTI futures contracts would be permitted to be traded from within the US without being subject to any federal oversight by US regulators.

The core regulatory policy question is, of course, whether the WTI crude oil futures contract is a foreign contract or whether it is a US futures contract requiring ICE Futures to become a US designated contract market to list WTI crude oil futures contracts for trading within the US. The CFTC has not yet addressed formally what factors to consider in determining whether a futures contract is domestic (requiring CFTC designation) or foreign (subject to foreign regulatory authority). Given the great importance of US crude oil products to every facet of the US economy and given the change in the underlying factual circumstances in the last several years, this issue is now clearly ripe for consideration by the full Commission.

As best as we can determine, this is the first instance since foreign terminals have been permitted in the US under CFTC staff no-action relief that the product offered on the electronic terminal of the foreign market is not a foreign product, but is instead a US product that directly involves physical energy markets in the US. While we have the greatest respect for the dedicated staff of DMO, given the announced plans that ICE will list a US product on its foreign terminal in the very near future without the benefit of any CFTC oversight or review, we believe that this is an issue that needs to be immediately considered by the CFTC's Commissioners.

NYMEX believes that that the new WTI futures contract to be listed by ICE Futures is a US product for the following reasons: It is a US product – WTI crude oil is of course drilled and produced in the US and constitutes a substantial and growing market in the physical "cash" crude oil commodity. WTI crude oil is distributed throughout much of the US via an extensive pipeline that has far-reaching effects upon other US energy markets and products and upon interstate commerce generally. Significantly, the settlement price to be used by ICE Futures will be based on the NYMEX (US futures market) settlement price.

A US futures contract could also be distinguished from a foreign futures contract based on the amount of US participation on that market. If the trading volume of a foreign exchange reflects or clearly can be predicted to involve a certain level of US participation, then the contract should no longer be viewed as a foreign contract, but rather as a domestic contract subject to all rules of a US designated contract market. In fact, this is the very reason why the Commission, has required, as a condition to the foreign terminal no-action letters, that each foreign market provide the CFTC with quarterly statistics measuring the volume of business being conducted from the US. In this case, it is clearly and readily foreseeable that a very substantial proportion of the trading in this new WTI contract will be conducted by US firms and traders. This reality alone may be sufficient for the Commission to warrant determining that this contract is a US contract and thereby requires the full oversight and daily monitoring by the CFTC and the CFTC's committed and experienced surveillance staff. (Absent specific data regarding ICE Futures' other products, we are unable to comment directly on whether the expanding US participation in recent years in the foreign-based ICE Futures products additionally would provide a further basis for reviewing the appropriateness of DCM registration for ICE Futures).

If the Commission fails to act now, ICE Futures would have the benefit of being a player in US markets by offering what is clearly a US contract, on a US based trading system that targets predominantly US trading firms and companies, while avoiding the related duty to register and to comply with CFTC oversight.

This stands in marked contrast to other non-US exchanges that have stepped up to the plate to compete with US markets on an equal footing and on a level playing field by registering their US affiliates with the CFTC as DCMs. Thus, for example, Eurex formed a US subsidiary, which registered as a DCM for the purpose of trading US Bond and Note futures, which are quintessential US products, and LIFFE and NASD formed NQLX as a DCM to trade US security futures.

There has been a substantial level of market volatility in a number of US energy markets in recent years, and it is quite possible that this volatility may continue for a good while into the future. As you know, the Commission, both on its own initiative and at the request of Congress, has undertaken a number of reviews examining market activity for US energy products. The CFTC was able to do so effectively only because it had available market surveillance tools in the form of large trader reporting on NYMEX-listed contracts. NYMEX, as a DCM, has reportable levels, large trader reporting, position limits or position accountability levels and an effective market surveillance function. Unless ICE Futures were to register as a DCM, the CFTC would not have ready access to important market and financial surveillance information regarding an important segment of the US energy markets and its market surveillance capabilities would be significantly compromised.

Absence a timely policy review by the Commission, ICE's proposal raises the very real prospect that other exchanges may follow suit and engage in this same type of "regulatory arbitrage" by shifting regulated US contracts to an overseas affiliate. The result could be that the CFTC could lose effective control and oversight over the markets that are expected to be under its supervision.

In the immediate term, the ICE plan would have pronounced effects upon US energy markets, including those regulated by the Commission and the related cash market in the underlying commodity. The potential impact, includes, among other things, a loss of transparency, the potential for attempted manipulation of a CFTC-regulated market's settlement price by traders attempting to influence the settlement price on the non-CFTC regulated market, shift of liquidity from the CFTC regulated market to the non-CFTC regulated market, and a reduced capability of the Exchange and the CFTC to maintain the high quality market surveillance programs needed to protect public customers. These actions would have a major adverse impact on the ability of the CFTC to fulfill its public mission under the Commodity Exchange Act.

In the context of the current review by the CFTC of SRO governance and mechanisms you noted in a recent speech that:

> "[a]t the most fundamental level, the goal of our self-regulatory framework is to

protect the people who rely on the proper functioning of the futures markets – and today nearly everyone is affected by activity in these markets, whether they choose to participate in them or not. The price paid for goods across a range of industries -- heating oil being a prominent one -- is determined, in large measure, in the futures markets. That goal -- to put the interests of the public first -- must remain paramount. "

Address by Chairman Reuben Jeffery III on The Futures Markets 2005: Integrity, Accountability, and Competition, New York, New York, December 1, 2005.

However, under the approach allowed pursuant to the existing staff position, neither the Commission itself nor its regulated markets will have any transparency regarding the market activity and trading of US-based products on markets that are not subject to CFTC oversight. This blind spot in surveillance and monitoring at both the Commission and SRO level creates the risk of market activity occurring off the CFTC's radar screen that nonetheless could have an extremely damaging spill-over impact upon the markets regulated by the CFTC. (This would be the case even if the fact pattern did not involve the non-US market acting as a free rider by appropriating the settlement prices made available by the regulated market.) If the Commission is to be truly serious about effective SRO regulation in the US, it must not tolerate such a gaping loophole in the scope of its oversight of US-based products. . . .

In closing, on behalf of the Exchange, I am respectfully requesting that the CFTC's Commissioners carefully consider the regulatory and other policy implications of the ICE proposal. We look forward to working with you and the Commission whenever so requested as you focus upon this critically important and timely policy matter.

Sincerely,

Chris K B

Christopher K. Bowen
General Counsel and
Chief Administrative Officer

cc: Commissioner Sharon Brown-Hruska
Commissioner Walter Lukken
Commissioner Fred Hatfield
Commissioner Michael Dunn
Rick Shilts